

Docket Nos. 00-0233/0335 (Consol.)

ICC Staff Exhibit 1.0 on Rehearing

ILL. C. C. 00-0233/0335

*Acc Stg 1.0 on Rehearing*

*12/18/01*

DIRECT TESTIMONY ON REHEARING

OF

GENIO STARANCZAK

PRINCIPAL ECONOMIST

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS UNIVERSAL SERVICE FUND

DOCKET NOS. 00-0233/0335 (CONSOL.)

DECEMBER 6, 2001

## Table of Contents

Witness Identification.....	1
Purpose of Testimony.....	1
The Affordable Rate.....	1
Primary vs. Secondary Lines.....	9
Phase In.....	12

1 **Q. Q. What is your name, title and business address?**

2  
3 A. My name is Genio Staranczak. I am employed by the Illinois  
4 Commerce Commission as principal economist in the Telecommunications Division.  
5 My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

6  
7 **Q. Are you the same Genio Staranczak that filed testimony in this docket on**  
8 **behalf of Staff on May 11, 2001?**

9  
10 A. Yes I am.

11  
12 **Q. What is the purpose of your testimony?**

13  
14 A. The purpose of my testimony is to (1) analyze the Verizon's, IITA's and Staff's  
15 affordable rate proposals (2) discuss the administrative and other issues associated  
16 with limiting subsidies to primary lines and (3) examine whether there should be a  
17 phase-in of the Commission's proposed affordable rate.

18  
19 **The Affordable Rate**

20  
21 **Q. Verizon witness Dr. Beauvais proposed an affordable rate of \$22.23 based on**  
22 **what he estimated a typical residential Verizon customer would pay monthly**  
23 **for local telephone service. Other parties claim Dr. Beauvais' affordable rate**

calculations are inaccurate, and when these errors are corrected the affordable rate becomes \$20.39. Could you please summarize the arguments made by each party to support its affordable rate calculation?

A. Dr. Beauvais' proposed affordable rate was based on what he estimated a typical rural residential Verizon subscriber would pay per month for local telephone service. This figure was computed by adding the rate for access in Verizon's rural exchanges (\$16.99) with the mean expenditure for local usage, including both home exchange and extended area, by Verizon's residential customers in Illinois (\$5.24) to arrive at a total monthly rate of \$22.23 per month (Verizon Exhibit 4, page 10). On cross examination, however, Dr. Beauvais stated that usage "would translate to roughly 100 local calls, somewhere around 400 minutes a month" (Transcript at pages 378 and 379).

Harrisonville witness Mr. Hoops asserts (Harrisonville Exhibit 6, page 16) that Verizon's local rate is just \$.034 per call, and so 100 local calls would cost the subscriber only \$3.40 per month. According to the IITA and other intervenors, therefore, the typical Verizon rural residential subscriber pays \$20.39 for telephone service (\$16.99 for access plus \$3.40 for usage) and the affordable rate should therefore be set at \$20.39 a month rather than \$22.23 a month as Verizon argued.

**Q. Which of the two affordable rate calculations is correct?**

**A.** It is hard to say for certain but it is more likely that the \$22.23 affordable rate calculation is correct. Verizon breaks out various charges on the bill it sends to customers every month. Access charges, local usage charges, long distance charges, etc., are listed on separate lines. It would be fairly straightforward to extract local usage charges from residential bills and then average these charges over all residential subscribers. This best explains how Dr. Beauvais arrived at precisely \$5.24 in local usage expenditures and also explains why Dr. Beauvais under cross examination stated that usage expenditures "would translate into roughly 100 local calls". Under the approach to estimating mean local usage expenditures I have outlined, Dr. Beauvais would not know (or need to know) exact monthly local calling volume.

**Q. Is there any other way that Dr. Beauvais could have come up with \$5.24 in mean usage expenditures?**

**A.** Yes. In addition to the various charges listed above, Verizon's bills also quantify the number of local calls a subscriber makes during the month. Dr. Beauvais could have extracted the number of calls from these bills and then calculated the average number of calls per subscriber. To arrive at mean usage expenditures he would then have to multiply the mean number of calls by the average price of a local call. If Dr. Beauvais did adopt this methodology he would, somehow, have had to come up

with an average price per call of \$0.0524. Note that this method of estimating local usage expenditures involves three steps, calculating average monthly usage, calculating the average price for a call and then multiplying the two figures together. This is considerably more awkward, and consequently less likely, than the simple one step procedure I discussed previously. Moreover, if Dr. Beauvais did use this methodology, he would know the exact number of local calls made each month and not have to "roughly" approximate this figure from local usage expenditure data.

**Q. But if the average Verizon residential subscriber does indeed make 100 local calls a month, would not his usage charges in fact total \$3.40 per month as IITA claims?**

**A.** No. The \$0.034 per call rate that is used in the IITA's usage expenditure calculation is the price of a local call for a Verizon subscriber in the subscriber's home exchange. EAS calls are priced substantially above \$0.034. For example, a Verizon subscriber living in Chatham, located just south of Springfield, who has EAS to Springfield, is charged either a flat \$0.11 for each call into Springfield or is charged \$.030 for connection and \$0.018 for each minute of this call. Consequently, 100 local calls, which are defined by Dr. Beauvais to include EAS calls, could easily be consistent with \$5.24 in mean local usage expenditures.

89 **Q. Are there any other issues the Commission should be aware of concerning**  
90 **the usage component of the affordable rate calculations?**  
91

92 A. Yes. The \$5.24 mean usage expenditure figure, used by Verizon in its affordable  
93 calculation (and by implication the 100 call figure used by the IITA in its affordable  
94 rate calculation), applies only to residential subscribers. (Verizon Exhibit 4.0, p. 10) It  
95 is likely that business subscribers will have different (and higher) mean monthly  
96 usage expenditures than residential subscribers. First, business subscribers will  
97 have different calling volumes than residential subscribers. Second, they face  
98 different prices. Business subscribers in Verizon home exchanges, for example, pay  
99 \$0.018 for connection and \$0.0093 for each additional minute, as opposed to a flat  
100 \$0.034 per call paid by residential subscribers. Third business subscribers will have  
101 a different mix of EAS and home exchange calls than residential subscribers.  
102

103 If business subscribers do spend more on usage than residential subscribers, then  
104 the \$5.24 mean local usage expenditures figure quoted by Dr. Beauvais is too low  
105 for the all line affordable rate calculation. To establish one affordable rate for both  
106 business and residential subscribers, the Commission must estimate the mean  
107 usage expenditures per month for all lines (business and residential combined)  
108 which for the reasons I have discussed is likely to be higher than \$5.24.

109 Alternatively, the Commission can establish two affordable rates, one for business  
110 and one for residential. The residential affordable rate would be based on Verizon's

mean residential expenditures for local usage while the business rate would be based on Verizon's mean business expenditures for local usage.

**Q. How would you recommend that the Commission resolve the issues concerning the affordable rate calculations that you have brought up?**

**A.** I brought up these issues concerning the affordable rate calculation in an effort to demonstrate how complicated such a computation could be. The Commission should take into account Dr. Beauvais', as well as other parties' estimates of what a typical rural Verizon subscriber may pay for telephone service when it sets the affordable rate. But it must recognize that all these estimates will be ballpark approximations of the truth, at best. For example, the IITA propose to set the affordable rate based on a monthly calling figure (100) that was derived as a "rough" translation from usage expenditure data and a local call tariff (\$0.034) that only applies to the home exchange. Verizon's own affordable rate proposal is based on expenditure data that lacks supporting documentation (e.g. Verizon's local usage expenditures figures may be based on an unrepresentative month or they may be outdated) and is inappropriate (e.g. Verizon bases its affordable rate proposal on local residential usage expenditures whereas it should have been based on local all line [residential and business combined] usage expenditures). The more the various parties dig, the more shortcomings they find in all the affordable rate calculations. The Commission, therefore, is best advised to abandon the notion that the affordable rate should be set



at a level that exactly corresponds to what a typical rural Verizon customer pays because no party, in Staff's opinion, has estimated this correctly.

~~Since Verizon's and the IITA's proposed affordable rate lack adequate support, the Commission should adopt Staff's original affordable rate proposal of \$24 a month for residence and \$27 a month for business. Staff continues to believe that for horizontal equity reasons<sup>1</sup>, the affordable rate should be set at a level higher than a typical rural Verizon subscriber might pay. Moreover, this type of decision will allow the Commission to avoid the statistical quagmire associated with determining what constitutes a "typical" Verizon subscriber, how many calls this subscriber makes, and how much that "typical" subscriber pays for usage and whether to adjust for the size of local calling areas, whether to adjust for EAS calling etc. Any order that "rules" on these issues openly invites further litigation.~~

~~Again, Staff notes that some IITA member company subscribers already pay local rates in excess of Staff's original affordable rate proposal (e.g. residential subscribers in the Frontier Lake Kirksville exchange pay \$30.69 a month and in the Frontier Midland Woodburn exchange pay \$24.33 a month) while other IITA subscribers pay rates close to Staff's affordable rate (e.g. Yates City residential subscribers pay \$22.45 a month). Affordable rates in other states, such as Wyoming, have been set~~

<sup>1</sup> Horizontal equity in this context means that USF eligible subscribers should not be treated more favorably than similarly situated Verizon subscribers. In particular, USF eligible subscribers must pay rates for telephone service that are higher than similarly situated Verizon subscribers pay. Subscribers who receive subsidies should not end up paying lower telephone rates than subscribers who are taxed to provide these subsidies. If USF eligible subscribers, because of the subsidies they receive, end up paying lower telephone rates than similarly situated Verizon subscribers, then this violates a basic principle of horizontal equity.

153 ~~at much higher levels (\$34) than what Staff is proposing for Illinois. Staff Exhibit 3.0~~  
154 ~~at 14 (filed in the original proceeding). Moreover, adopting Staff's affordable rate~~  
155 ~~proposal would also serve to reduce the size of the USF fund and lessen the burdens~~  
156 ~~placed on other subscribers in Illinois who will support this fund through surcharges.~~

157  
158 ~~The Commission may be reluctant to adopt \$24 and \$27 as affordable rates because~~  
159 ~~the figures seem to be arbitrary. Setting an affordable rate, however, is a policy~~  
160 ~~decision that ultimately requires the exercise of reasoned judgment. Many policy~~  
161 variables are set solely based on reasoned judgment. For example, reasoned  
162 judgment is used to set the income eligibility limits for many social programs (e.g  
163 welfare and Medicaid), reasoned judgment is used to set federal and state tax rates  
164 as well as the exact dollar level of personal deductions and credits, reasoned  
165 judgment is used to set age eligibility criteria for Social Security (why 65 and not 60 or  
166 70?) and reasoned judgment should be used to set the affordable rate.

167  
168 The alternative for the Commission is to adopt one of the other affordable rate  
169 proposals (\$22.23 or \$20.39). These figures are purported to be based on what a  
170 typical Verizon subscriber pays for local telephone service. But, Staff has  
171 demonstrated above that the calculations underlying either of these numbers are  
172 faulty. Moreover both proposals are based on "data" that is either "roughly"  
173 approximated or that lacks supporting documentation. The Commission therefore,  
174 has the choice of picking an affordable rate (\$22.23 or \$20.39) that it is fundamentally

~~flawed and inconsistent with horizontal equity, or picking an affordable rate (\$24 and  
\$27) that is based on reasoned judgment and is consistent with horizontal equity.~~

**Primary vs Secondary Lines**

**Q. Should the USF provide subsidies to all lines or just primary lines?**

A. The USF should provide subsidies to all lines. Limiting funding to primary lines will create administrative and enforcement difficulties, cause rate shock for many business and residential second line subscribers, and result in more "deadweight loss" activity in society as a whole.

First, it will be administratively difficult to differentiate primary lines from non-primary lines on a consistent basis. For example, some USF eligible companies define non-primary residential lines as second and additional lines listed on a residential account. Under this definition, the household with two lines listed on one account, would have an incentive to open a second residential account under the name of a different household member to avoid paying the higher charges associated with a second residential line. This will create enforcement problems and could lead to the perception of unfairness, if some subscribers who have a second residential line pay the higher rate, while other households who have a second residential line avoid paying the higher rate by registering the second line on a separate account.

198 On the other hand, other USF eligible companies define a non-primary line as  
199 second, and additional lines to a particular residential address. This way of  
200 identifying a non-primary line could cause some households to be "overcharged" for  
201 their line if two or more households reside at one location. For example, a farm  
202 couple could have elderly parents or a "handyman" living with them. The parents or  
203 the "handyman" might need a separate phone for privacy or billing reasons. But  
204 under the location definition of a non-primary residential line, the second and third  
205 lines into this location would be charged the higher non-primary rate, even though  
206 for all practical purposes these second and additional lines are primary lines for the  
207 second household residing at this location. This definition of non-primary lines could  
208 lead to attempts by households to set up separate mailing addresses for each line in  
209 an attempt to avoid paying higher charges for the second line.

210  
211 The same type of administrative problems could occur if subsidies are denied to  
212 multi-line business subscribers. For example, a business with two or more lines,  
213 could try to set up separate accounts for each line in an attempt to avoid paying  
214 higher charges associated with the second line. In addition, the rationale for denying  
215 subsidies to second residential lines -- second lines are discretionary -- does not  
216 necessarily apply to multi-line business users. Presumably businesses subscribe to  
217 a second line because second lines are necessary to run the business and not just  
218 because they are "nice" to have.

Subscribers who have a second line might also experience rate shock if USF funding is denied to the second line. IITA's analysis suggests that monthly rates for a second line (either business or residence) would have to rise to about \$75 for Moultrie and Home subscribers, \$60 for Madison subscribers and \$50 for Egyptian subscribers. If rates rise, residential subscribers are much more likely to drop service for second lines than for primary lines, because second lines are more discretionary than primary lines. At these rates, therefore, some subscribers will cancel service which will cause IITA member companies financial problems, since they will lose revenue when the subscriber cancels service but their costs will remain essentially unchanged.

Finally, limiting subsidies to primary lines will result in more "deadweight loss" activity. Eliminating subsidies for non-primary lines induces subscribers to disguise second lines as primary lines in order to receive subsidies. All the time and effort associated with this activity (setting up separate accounts for each line, setting up separate addresses etc), and all the time and effort associated with trying to prevent it is unproductive from a social point of view. Resources are diverted from producing goods and services and directed to procuring subsidies. The Commission should not set up subsidy schemes that encourage "deadweight loss" activities.

**Q. If the Commission does indeed decide to subsidize only primary lines, should subsidies be limited to single line business subscribers or should the first line of multi-line business subscribers be eligible for subsidies as well?**

243

244 A. If the Commission does decide to subsidize only primary lines, then all business  
245 subscribers should have their first line subsidized. It makes no sense to deny  
246 subsidies to a business subscriber's first line, just because that business subscriber  
247 has additional lines.

248

249 **Phase-In**

250

251 **Q. Should the Commission implement the affordable rate immediately or should**  
252 **the Commission phase-in the affordable rate over a number of years?**

253

254 A. The Commission should phase-in the affordable rate over a number of years to  
255 prevent rate shock and to reduce economic hardship for subscribers of rural  
256 telephone companies. If Staff's affordable rate proposal is adopted, the phase-in  
257 period should be five years. Rates would rise each year by one-fifth of the  
258 difference between the subscriber's current rate and Staff's proposed affordable  
259 rate, or \$2, whichever is greater.

260

261 If Verizon's proposed affordable rate of \$22.23, or a figure in that range is adopted,  
262 the phase-in period should be four years. Rates would rise each year by one-fourth  
263 of the difference between the subscriber's current rate and Verizon's proposed  
264 affordable rate of \$22.23, or \$2, whichever is greater. Staff believes that lower

affordable rates do not require as long a phase in period as higher affordable rates, since there is less hardship for subscribers to adjust to.

Finally, if the claims of the IITA and similar intervenors are accepted and the affordable rate is set at \$20.39, or a figure in that range is adopted, then the phase in period should be three years. Rates would rise each year by one-third of the difference between the subscriber's current rate and the intervenors' proposed rate of \$20.39, or \$2, whichever is greater. The phase in would occur once a year starting on October 1, 2001.

**Q. Some parties claim that there should not be any affordable rate phase-in because rural telephone companies have been on notice for many years that subsidies to their subscribers would end, and that they have not taken any steps during that time period to raise rates. How do you respond to this argument?**

**A.** Although rural telephone companies have been on notice that the DEM weighting fund was temporary and would end, they did not have any clear idea of how much, if at all, they should raise their rates before permanent funding was established. In fact, these companies appear to have concluded that any permanent universal support fund would exactly replace the subsidies they were receiving under the DEM weighting fund, and that they would not have to raise rates at all. This was the position the IITA adopted in this proceeding – the affordable rate should be the rate

288 currently in effect – and they were not alone in their thinking, since the Proposed  
289 Order in Phase I of this proceeding adopted this position as well. Moreover,  
290 notwithstanding the actions (or inaction) of the rural telephone companies, Staff does  
291 not believe that subscribers of rural telephone companies should be compelled to  
292 bear unnecessary financial burdens or suffer rate shock, where this can be alleviated  
293 through a phase in of the affordable rate. Therefore, the affordable rate should be  
294 phased in over a period of time.

295

296 **R. Does this conclude your testimony?**

297

298 **A. Yes it does.**

299